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Supreme Court, U.S.
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No. _____

# In The

# Supreme Court of the United States

Ross L. Bair, *et al.*

*Petitioners,*

vs.

United States,

*Respondent.*

On Petition for Writ of Certiorari from the United States Court of Appeals to the Federal Circuit

## PETITION FOR WRIT OF CERTIORARI

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## QUESTIONS PRESENTED

1. Under a Fifth Amendment categorical takings analysis, does a previously enacted federal statute constitute a "background principle" of law under Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 112 S. Ct. 2886 (1992), thereby eliminating a compensable property interest that would otherwise exist as a matter of state law?

2. Can a federal statute preempt, and thereby render valueless, a state-created property right without triggering the requirement of paying just compensation under the Fifth Amendment?

## PARTIES TO THE PROCEEDING

**Petitioners (plaintiffs and appellants below):**

ROSS L. BAIR (LISTED PARTY), LYLE K. BAIR, BAIR BROTHERS, BAIR FARMS, INC., BERGESON FARMS, INC., CEEKAYDEE FARMS GENERAL PARTNERSHIP, KEITH B. CHILD; CORBETT DRAW FARMS GENERAL PARTNERSHIP, D &D GILBERT FARMS, INC., TOM DOWNS, J. LAMAR GILBERT, DAVID HAMMOND, JERRY HODGES, CHRIS HYER, JOHN HYER, MARK IVERSON, L. SHEFFELS & SONS, INC., LEON R. BAKER FARMS, LLC, JERRY C. MILBRANDT, R & J FAMILY FARMS, INC., ALLAN ROBEL, RONALD ROYLANCE FARMS, INC., ROYLANCE COULEE PARTNERSHIP, RANDY ROYLANCE, SBS FARMS, LLC, TRAVIS STEFFLER, PAUL STOKER, STOKROSE FARM AND FEEDLOT, TIM TAYLOR, TRACY LYBBERT FARMS, INC., DUANE MARCUSEN, LUIS A. MARTINEZ, FRANK MARTINEZ, LEGACY FARMS, INC., SHANE CHRISTENSEN, J. LYN WOOD, PIERCY FARMS, INC., AG CAPITAL COMPANY, KEVIN JENKS, ROGER ROYLANCE FARMS, INC., LARRY SCHAAPMAN, DAVID EDLER, CIRCLE D, INC., DIAMOND M, INC., D. GLEN BAIR, AND WASHINGTON STATE DEPARTMENT OF NATURAL RESOURCES.

Represented by Bryce J. Wilcox of LUKINS & ANNIS, P.S., 717 W. Sprague Avenue, Suite 1600, Spokane, WA 99201.

**PARTIES TO THE PROCEEDING - Continued**

**Respondent (defendant and appellee below):**

UNITED STATES OF AMERICA.

Represented by Steven Mager, Trial Attorney, Department of Justice, Civil Division, Commercial Litigation Branch, 1100 L Street, N.W., Room 7030, Washington, D.C. 20530.

## CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6, Petitioners state as follows:

There are no parent corporations and/or any publicly held companies that own 10 percent or more of the stock of the parties represented by me.

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## OPINIONS BELOW

The opinion of the United States Court of Appeals (Appendix A) is reported at 515 F.3d 1323 (Fed. Cir. 2008). The opinion of the Federal Court of Claims (Appendix B) is reported at 80 Fed.Cl. 287 (2007). The order of the Federal Court of Claims (Appendix C) and order denying the petition for rehearing *en banc* (Appendix D) were not reported.

## STATEMENT OF JURISDICTION

The decision of the United States Court of Appeals for the Federal Circuit was filed on February 5, 2008. That Court denied the petitioners' request for rehearing *en banc* on March 31, 2008. 28 U.S.C. § 1254(1) confers jurisdiction on this Court to review on writ of certiorari the opinion of the Court of Appeals.

## RELEVANT PROVISIONS INVOLVED

The underlying action was brought by petitioners pursuant to the Fifth Amendment to the Constitution, which reads as follows:

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or

> naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Respondents rely on 7 U.S.C.A. § 7284, the relevant portion of which is as follows:

> (d) A security interest obtained by the Commodity Credit Corporation as a result of the execution of a security agreement by the processor of sugarcane or sugar beets shall be superior to all statutory and common law liens on raw cane sugar and refined beet sugar in favor of the producers of sugarcane and sugar beets and all prior recorded and unrecorded liens on the crops of sugarcane and sugar beets from which the sugar was derived.

## STATEMENT OF THE CASE

Petitioners are growers and producers of sugar beets in Washington State ("the Growers"). Appendix A at p. 4 ("APP – 4") (Bair v. United States, 515 F.3d 1323 (Fed. Cir. 2008)). They

contracted with processor Pacific Northwest Sugar Company ("PNSC") to process their 2000 sugar beet crop into refined sugar. Id. The beets were delivered for processing on December 1, 2000. This gave the Growers a first priority statutory lien over the beets delivered, as well as sugar and proceeds from the sale of that sugar, under Washington law.[1] Id. at APP – 4-5.

Under the contract between the Growers and PNSC, if PNSC failed to make a payment under the contract, the Growers were entitled to foreclose and enforce the lien by a civil action in state court. Id. at APP – 5. Payment for the beets was to occur over the course of several months, but PNSC only made the first 55% of those payments. Id. at APP – 4.

The Commodity Credit Corporation ("CCC"), an agency of the United States within the Department of Agriculture, makes loans to sugar beet processors to support the domestic sugar market. Between October 10, 2000 and February 12, 2001, the CCC issued 21 nonrecourse loans to PNSC. Upon making these loans, the CCC acquired a security interest in the refined sugar produced by PNSC from the Growers' beets. However, the Growers' liens necessarily pre-dated the CCC loans and, therefore, had first-in-time priority over the CCC's liens. Nonetheless, the CCC's loans purportedly received "super priority" over the Growers' liens by virtue of 7 U.S.C. § 7284(d), which provides:

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1 RCW 60.13.020.

> A security interest obtained by the Commodity Credit Corporation as a result of the execution of a security agreement by the processor of sugarcane or sugar beets shall be superior to all statutory and common law liens on raw cane sugar and refined beet sugar in favor of the producers of sugarcane and sugar beets and all prior recorded and unrecorded liens on the crops of sugarcane and sugar beets from which the sugar was derived.

Id. at APP – 5-6.

After PNSC's default, the Growers timely filed statements evidencing their processor liens on March 22, 2001.[2] Id. On September 19, 2001, the Growers filed suit in Washington state court against both PNSC and CCC, seeking foreclosure of their liens and recovery of $8,714,690.00. Id. at APP – 6. The Government removed the action to the United States District Court for the Eastern District of Washington. The District Court granted summary judgment for the CCC, concluding that the plain language of 7 U.S.C. § 7284(d) afforded super priority to the CCC's liens. Bair v. Pac. NW Sugar Co., No. CS-01-0310, slip op. at 24 (E.D. Wash. Feb. 21, 2002). As a result, the CCC recovered $4,540,803.00 of its outstanding loans from the proceeds of the remaining processed

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[2] See RCW 60.13.050 (requiring producers to file liens within 20 days of payment due date in order to maintain priority over other security interests).

sugar. No sugar or proceeds remained to pay PNSC's debt to the Growers, and their liens were rendered worthless. APP – 6-7.

On November 19, 2004, the Growers filed a complaint in the United States Court of Federal Claims, alleging that application of 7 U.S.C. § 7284(d) exercised a taking under the Fifth Amendment. The Court of Federal Claims granted summary judgment in favor of the Government, holding that "[t]he Federal statement created a pre-existing limitation on the property rights that the Growers could acquire under state law." Bair v. United States, 80 Fed.Cl. 287 (2007). The court held, therefore, that the application of the statute did not constitute a taking. APP – 7.

The Growers timely appealed to the Federal Circuit Court, pursuant to 28 U.S.C. § 1295(a)(3). The Federal Circuit affirmed, holding that the Growers had no compensable property interest at the time of lien enforcement above the Government's super-priority lien interest based on federal law. Central to its conclusion that the Growers lacked a compensable property interest in their state-law liens, the Federal Circuit concluded that a federal statute can constitute a "background principle" of law in derogation of state-created rights to lien priority. The Federal Circuit also held that state laws that conflict with the federal super-priority statute were "preempted to the extent that they could not and did not grant appellants any compensable property interest at the time of the lien enforcement above the

government's super-priority lien interest based upon federal law." APP 10-19.

The Growers believed the Federal Circuit's opinion was in error and in direct contravention of Supreme Court precedent and its prior *en banc* decision in Presault v. United States, 100 F.3d 1525 (Fed. Cir. 1996), where the Federal Circuit expressly held that federal statutes cannot constitute "background principles" under Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 112 S. Ct. 2886 (1992). Thus, the Growers timely filed a request for hearing and/or for *en banc* review. This request was summarily denied on March 31, 2008.

## REASONS FOR GRANTING THE PETITION

The Growers assert that the Government's exercise of its super-priority lien rights under 7 U.S.C. § 7284(d) ("the super-priority statute"), which destroyed the Growers' ability to exercise their state-created lien rights, was a compensable, categorical taking under the Fifth Amendment. In rejecting the Growers' claim, the Federal Circuit determined that they had no cognizable property rights in their state-law liens because the super-priority statute was enacted prior to the time their lien rights arose, and further, to the extent state-law did create such a property right, it was preempted. In sum, the Federal Circuit held that the enactment of the super-priority statute prevented the Growers from ever obtaining a

recognized property interest in their state-law liens.

Fundamental to the Federal Circuit's decision was a holding that federal statutory law can prevent the creation of state-law property rights. Relying on Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 112 S. Ct. 2886 (1986) , the Federal Circuit found that the "background principles" of law encompassed prior enacted federal legislation like the super-priority statute. The Federal Circuit's holding rests on a faulty legal conclusion that Congress may prospectively redefine, and thereby destroy, state-created property rights through the enactment of federal legislation. Not only does such an assertion run contrary to prior Supreme Court cases and the Federal Circuit's *en banc* decision in Presault, it would effectively permit the Government to legislate around the Fifth Amendment by redefining what constitutes "property." In essence, the Federal Circuit held that the Growers' "bundle of rights" never included a stick representing priority because of the previously enacted federal statute. This Court in Nollan v. California Coastal Comm'n, 483 U.S. 825, 834 n.2, 107 S. Ct. 3008 (1987), described this very notation as a "peculiar proposition."

The Fifth Amendment protects "property" from being taken by the Government without just compensation. If Congress can preemptively eliminate a compensable property interest recognized under state law simply by enacting

legislation, the protection afforded by the Fifth Amendment would be in jeopardy. This Court should accept review of this case to clarify that the "background principles" in Lucas which can define the scope of property rights, do not include previously enacted federal legislation.

The decision of the Federal Circuit Court of Appeals regarding the Lucas "background principles" has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power. Supreme Court Rule 10(a). This is especially warranted, as the Federal Circuit's decision was in direct conflict with its prior, binding *en banc* decision in Presault. Furthermore, the Federal Circuit's decision conflicted with prior Supreme Court decisions or, alternatively, determined an important question of federal law which has not been addressed by the Supreme Court and should be. Supreme Court Rule 10(c).

## ARGUMENT

### A. State-Law Liens Constitute Property Under the Fifth Amendment.

"The Fifth Amendment prohibits the taking of private property for public use without just compensation." Palazzolo v. Rhode Island, 533 U.S. 606, 633, 121 S. Ct. 2448 (2001). Implicit in this analysis is the determination of whether there is a cognizable property interest at stake. See Conti v. United States, 291 F.3d 1334, 1339 (Fed. Cir.

2002); Adams v. United States, 391 F.3d 1212, 1218 (Fed. Cir. 2004). The issue here is whether a federal statute can prospectively eliminate what had been previously recognized under state law as a property right.

### B. State Law Defines the Scope of "Property" Rights Under Fifth Amendment.

It is well-established that "[p]roperty interests are created and defined by State law." Butner v. United States, 440 U.S. 48, 99 S. Ct. 914 (1979); see also Bd. of Regents of State Colleges v. Roth, 408 U.S. 564, 577, 92 S. Ct. 2701 (1972) (holding that property rights are "created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law"); and Phillips v. Washington Legal Foundation, 524 U.S. 156, 164, 118 S. Ct. 1925.

This Court has previously recognized that states have a "legitimate and traditional interest" in "creating and defining" property interests. Aquilino v. United States, 363 U.S. 509, 513-14, 80 S. Ct. 1277 (1960). This Court in Aquilino recognized that "in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property." The Court held that this "approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest

of its citizens, and the necessity for a uniform administration of the federal revenue statutes." Id. at 514; see Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1003, 104 S. Ct. 2862 (1984) (holding that intangible property rights "protected by state law are deserving of the protection of the Takings Clause"), and Logan v. Zimmerman Brush Co., 455 U.S. 422, 430-431, 1025 S. Ct. 1148 (1982) (hallmark of property "is an individual entitlement grounded in state law").

"A common idiom describes property as a 'bundle of sticks' - - a collection of individual rights which, in certain combinations, constitute property. ***State law determines which sticks are in a person's bundle.***" United States v. Craft, 535 U.S. 274, 122 S. Ct. 1414 (2002) (emphasis added). One of the most essential sticks in the Growers' bundle of rights is lien priority. When this right was taken, their liens were rendered valueless. If a regulation destroys an essential stick in the bundle of rights, just compensation must be paid under the Fifth Amendment. See Kaiser Aetna v. United States, 444 U.S. 164, 176 (1979) (recognizing that the regulation destroyed "one of the most essential sticks in the bundle of rights"); see also Hodel v. Irving, 481 U.S. 704 (1987).

The Federal Circuit cited to Craft and United States v. Kimbell Foods, 440 U.S. 715, 99 S. Ct. 1448 (1979), in support of the proposition that federal law determines what constitutes "property" for purposes of applying federal statutes. However,

this does not alter the fact that state law determines what is "property" for purposes of applying the Fifth Amendment. Federal law ***does not*** determine what constitutes "property" under the Fifth Amendment.

### C. Growers' Valid, State-Created Liens Which Pre-Dated the Government's Liens Were Taken Without Just Compensation.

Under Washington law, the Growers each possessed a compensable property interest in their Washington state processor liens. It was undisputed below that the Growers have valid state law liens under RCW 60.13.020, which were prior in time to the Government's liens. Nor was it challenged that liens arising under state law are compensable property interests for purposes of the Fifth Amendment. See Armstrong v. United States, 364 U.S. 40, 49, 80 S. Ct. 1563 (1960) (holding that the Government's destruction of subcontractor liens was a compensable taking); Shelden v. United States, 7 F.3d 1022 (Fed. Cir. 1993) (Government's acquisition of state-law mortgage rights constituted a taking); Murray v. United States, 817 F.2d 1580 (Fed. Cir. 1987) (Government's foreclosure of tax liens, which resulted in the loss of mortgage interests, was a compensable property interest); In re Metmor Financial, Inc., 819 F.2d 444 (4th Cir. 1987) (forfeiture of property under RICO statute to government, which deprived mortgage holders of

their right to enforce their interests, constituted a taking).

The seminal case on the applicability of the Fifth Amendment takings analysis to state law liens is Armstrong, 364 U.S. at 49, 80 S. Ct. 1563, 4 L. Ed. 2d 1554 (1960), where this Court found the extinguishing of an individual's lien rights to be a compensable taking under the Fifth Amendment. This Supreme Court held that the liens reflected compensable property interests within the meaning of the Fifth Amendment that were taken by the United States. Id. at 43-47. In reaching this holding, this Court recognized that before the Government acquired the vessels, the subcontractors had valid liens under state law. Id. at 46. "Before transfer these liens were enforceable by attachment against both the hulls and all materials. After transfer to the United States the liens were still valid, but they could not be enforced . . . . The result of this was a destruction of all [subcontractors'] property rights under their liens, although, as we have pointed out, the liens were valid and had compensable value." Id. at 46 (internal citation omitted) (emphasis added).

### D. Lucas "Background Principles" Do Not Include Federal Statutes.

In holding that the Growers had no compensable property interest in their state-law liens, the Federal Circuit relied heavily on the "background principles" of law language in Lucas. There, this Court clarified that in a categorical

taking, an individual's state-created property rights may be limited by the "background principles of state law." Lucas, 505 U.S. at 1029. Under this principle, no compensable taking occurs if restrictions on property were implicit in existing ***state*** "nuisance and property laws." Id. at 1030. Accordingly, in determining whether a compensable property interest exists, the only relevant inquiry is whether there are restrictions on the property interest that "inhere in the title itself, in the . . . background principles of the ***state's law*** of property and nuisance already placed upon land ownership." Lucas, 505 U.S. at 1029 (emphasis added).

The "relevant background principles" discussed by the Court in Lucas were only those existing under state law. As the Court held, this is because state laws "define the range of interests that qualify for protection as 'property' under the Fifth (and Fourteenth) amendments." Id. at 1031. Indeed, Lucas cautioned against using legislatively decreed background principles.

In discussing regulations that prohibit all economically beneficial use of property, the Court held that any "limitation so severe cannot be newly legislated or decreed (without compensation), but must inhere in the title itself, in the restrictions that background principles of the State's law of property and nuisance already place upon the land ownership." Id. at 1029.

Contrary to the Federal Circuit's holding, nothing in Lucas suggests that federal law can be used to redefine state property interests. Using federal law to define what "sticks" are included in the "bundle" of state-created property rights would impermissibly allow the Government to avoid the Fifth Amendment by altering the characteristics of "property." If such a rule were adopted, all state-created property interests would be in jeopardy if the Government decided, as it did here, to redefine what constitutes "property."

Within the discussion of compensable property interests in Lucas, this Court looked to "'existing rules or understandings that stem from an independent source such as state law' to define the range of interests that qualify for protection as 'property' under the Fifth and Fourteenth Amendments." Id. at 1030 (quoting Board of Regents of State Colleges, 408 U.S. at 577, and citing Monsanto, 467 U.S. at 1011-1012, and Hughes v. Washington, 389 U.S. 290, 295, 88 S. Ct. 438 (1972) (Stewart, J., concurring)). The authority cited in Lucas supports the Growers' argument.

In Board of Regents, this Court held that "[p]roperty interests, of course, are not created by the Constitution. Rather they are created and their dimensions are defined by existing rules or understandings that stem from an independent source ***such as state law-rules*** or understandings that secure certain benefits and that support claims of entitlement to those benefits." Id. at 577 (emphasis added). There is no mention of federal

law. Similarly, this Court's citation to the concurring opinion in Hughes illustrates the same: "Surely it must be conceded as a general proposition that the law of real property is, under our Constitution, left to the individual States to develop and administer." Hughes, 389 U.S. at 295 (Stewart, J. Concurring). Monsanto, the final case cited in Lucas, also dealt with state-created trade secrets. Monsanto, 467 U.S. at 1011-1012.

Lucas is clear that only state law is relevant in defining "background principles" and the range of interests that qualify for protection as compensable property. Nonetheless, the Federal Circuit asserts that Lucas' reference to Scranton v. Wheeler, 179 U.S. 141, 163, 21 S. Ct. 48 (1900), shows this Court also intended to incorporate federal law into the "background principles" analysis. Scranton does not appear to stand for this proposition.

In Scranton, this Court held that no taking existed because the riparian owner's title "was acquired subject to the rights which the public have in the navigation of such waters." Scranton, 179 U.S. at 163. However, the pre-existing rights cited in Scranton also existed under Michigan law.

> "But it is equally settled in [Michigan] that the rights of the riparian owner are subject to the public easement or servitude of navigation. So that, whether title to the submerged lands of navigable waters is in the state or in the riparian owners, it was acquired subject to the

> rights which the public have in the navigation of such waters."

Id. at 163 (citations to Michigan case authority omitted).

Accordingly, when the Court in Lucas cited to Scranton for the proposition that the government could "assert a permanent easement that was a pre-existing limitation upon the landowner's title," it did so for the purpose of confirming the state's role in defining property rights. The fact that the Court in Lucas cited to page 163 of Scranton, the page where the above-quoted language appears recognizing that the navigation servitude was created and recognized under ***state law***, illustrates that Scranton does not stand for the proposition that federal law can independently create such a servitude. For this reason alone, Lucas cannot be read as standing for such a proposition.[3]

In Ruckelshaus v. Monsanto Co., 467 U.S. at 1011-1012, a partial regulatory takings case, the Supreme Court considered whether a federal statute limited state property rights. Monsanto involved the mandatory disclosure, under federal law, of trade secrets protected by state law. Contrary to the Federal Circuit's characterization,

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[3] Further, as Scranton dealt with issues relating to Congress' broad Commerce Clause powers, which create its authority over navigation, the Growers do not believe this Court in Lucas intended to incorporate all federal law into "background principles" by a mere passing reference to the case, especially when the Court spent considerable time addressing "background principles" created by state law.

Monsanto did not deal with pre-existing rights created under federal law that were described as "background principles." Rather, it dealt with "intangible property rights protected by ***state law***" and that to the extent Monsanto possessed such a right "under ***Missouri law***, that property right is protected by the Takings Clause of the Fifth Amendment." Monsanto, 467 U.S. at 1003-1004 (emphasis added).

The Government in Monsanto urged the Court to "to view the situation not as a taking of Monsanto's property interest in trade secrets, but as a 'pre-emption' of whatever property rights Monsanto may have had in those trade secrets." Monsanto, 467 U.S. at 1012. In rejecting this argument, the court held:

> This argument proves too much. If Congress can "pre-empt" state property law in the manner advocated by EPA, then the Taking Clause has lost all vitality. This Court has stated that a sovereign, "by ipse dixit, may not transform private property into public property without compensation . . . This is the very kind of thing that the Taking Clause of the Fifth Amendment was meant to prevent."

Id. (citations omitted).

Because some value remained in Monsanto's trade secrets even after disclosure, the Court used a partial takings analysis. It held that Monsanto's trade secrets were "taken" to the extent it had a

reasonable investment-backed expectation that they remain confidential. Conversely, the Court found that trade secrets were not taken if disclosed when legislation was in effect that did not reasonably provide assurances of confidentiality. The Court explained its rationale as follows: "a voluntary submission of data by an applicant in exchange for the economic advantages of registration can hardly be called a taking." Id. at 1007. That is to say, no takings existed after enactment of the legislation, not because state property rights were thereby redefined and eliminated, but because Monsanto voluntarily relinquished its property rights in its trade secrets by disclosing them to the EPA in exchange for a valuable government benefit. Monsanto is inapplicable here because the Growers never received their "valuable government benefit" in exchange for super-lien priority afforded to the Government.

Monsanto was explained by this Court in Nollan v. California Coastal Comm'n, 483 U.S. 825, 833, 107 S. Ct. 3008 (1987). In Nollan, this Court rejected a lower court's use of a "constructive notice" rule as destroying a land owner's property interest for purposes of a takings analysis. Nollan, 483 U.S. at 833. This Court held that the Nollans' reasonable expectations were not defeated merely because they purchased land long after the Commission had begun conditioning building permits on agreeing to access easements. Nollan, 483 U.S. at 833 n.2.

Justice Brennan's dissent in Nollan emphasized that the agency had imposed similar conditions on forty-three of the Nollans' neighbors, thereby putting the Nollans "on notice" that lateral access to the beach would be a condition of approval. Nollan, 483 U.S. at 857-58 (Brennan, J., dissenting). In support of his dissenting view, Justice Brennan relied upon Monsanto, utilizing the same logic advanced by the Federal Circuit below. In response, the majority observed that Justice Brennan cited Monsanto "as support for the ***peculiar proposition*** that a unilateral claim of entitlement by the government can alter property rights." Nollan, 483 U.S. at 833 n.2 (emphasis added).

Nollan confirmed that, in Monsanto, the Takings Clause was not violated by the federal statute because, in exchange for trade secret disclosure, the statute provided the "*valuable Government benefit*" of obtaining registration of an insecticide. Because there was a voluntary exchange between Monsanto and the Government (trade-secret information for a Government benefit), there was no taking. Unlike Monsanto, the Court in Nollan concluded that the right to build on one's own property, even though it may be limited by regulation, "cannot remotely" be described as a "governmental benefit." Thus, the court found the "voluntary exchange" in Monsanto was not present. Nollan, 483 U.S. at 833 n.2.

Monsanto was also discussed by three concurring justices in Presault v. ICC, 494 U.S. 1,

22-23, 110 S. Ct. 914 (1990) (JJ. O'Connor, Scalia, and Kennedy concurring). In Presault, this Court considered the impact of regulations enacted by the ICC on state law. Citing Monsanto, the concurring justices noted that "although the Commission's actions may pre-empt the operation and effect of certain state laws, ***those actions do not displace state law as the traditional source of the real property interests***." Id. (emphasis added). The Court observed that the ICC's actions could result in the elimination of state property interests. "Any other conclusion would convert the ICC's power to pre-empt conflicting state regulation of interstate commerce into the power to pre-empt the rights guaranteed by state property law, ***a result incompatible with the Fifth Amendment***." Id. (emphasis added).

More recently, in Palazzolo, this Court considered whether the post-regulation acquisition of property affected by wetland regulations was "fatal" to the plaintiffs' partial regulatory takings claim. Id. at 612-13. The State asserted that Lucas "stands for the proposition that any new regulation, once enacted, becomes a background principle of property law which cannot be challenged by those who acquire title after enactment." Id. at 629. While the Court did not need to resolve when a legislative enactment "can be deemed a background principle of state law," it did note that a regulation that would be otherwise unconstitutional absent compensation "is not transformed into a background principle of the State's law by mere virtue of the passage of time." Id. at 629-630. This

Court held that such a relative standard would be incompatible "with our description of the concept in Lucas, which is explained in terms of those common, shared understandings of permissible limitations derived from a State's legal tradition." Id. at 630. Further, this Court held that a takings claim "is not barred by the mere fact that ... title was acquired after the effective date of the state-imposed restriction." Id. at 630.

The Court's repeated reference in Palazzolo to background principles of "state law" under Lucas confirms that it did not intend to include federal law into limiting background principles:

> So, the argument goes, by prospective legislation the State can shape and define property rights and reasonable investment-backed expectations, and subsequent owners cannot claim any injury from lost value. After all, they purchased or took title with notice of the limitation.
>
> The State may not put so potent a Hobbesian stick into the Lockean bundle. . . .Were we to accept the State's rule, the post-enactment transfer of title would absolve the State of its obligation to defend any action restricting land use, no matter how extreme or unreasonable. A state would be allowed, in effect, to put an expiration date on the Takings Clause. This ought not to be the rule.

Id. at 613. For this reason, the Court held that a

"law does not become a background principle .... by enactment itself. Lucas did not overrule our holding in Nollan ...." Id. at 630.

In Presault v. United States, 100 F.3d 1525 (Fed. Cir. 1996) (*en banc*), the Federal Circuit sitting *en banc* considered whether the Government's conversion of a long unused railroad right-of-way to a public recreational hiking trail under authority of the federal Rails-to-Trails Act constituted a taking. The Government in Presault argued that the federal Rails-to-Trails Act, in place since 1920, formed part of the "background principles of state law," for purposes of a categorical takings analysis under Lucas. Id. at 1538. And, as a consequence, the Presaults

> "should have anticipated that at some time in the future the Government might exercise its general regulatory powers in a way that could frustrate the Presault's interest[s]. . . . [T]he Presaults cannot complain that anything was taken from them; the title acquired by the Presaults in effect has been modified by the history of federal regulatory enactments."

Id. at 1539.

Specifically, relying on Lucas, it was argued in Presault that there was "nothing to preclude the use of federal law as well as state law in selecting the relevant 'background principles.'" Id. at 1539. The Federal Circuit, however, held that "Lucas

provides no such support," therefore expressly rejecting the exact ruling made by the Federal Circuit Panel in this case:

> Nothing in Lucas suggests that the background principles of a state's property law include the sweep of a century of federal regulatory legislation, and indeed much of what the Supreme Court said then, as well as in Presault II, about property rights indicates to the contrary.

Id. at 1538-39. The argument was "rejected categorically." Id. at 1540.

### E. Prior Federal Circuit Takings Cases Do Not Support the Proposition Adopted by the Federal Circuit in This Case.

In its decision below, the Federal Circuit cited several of its prior decisions in support of its holding that "federal statutes can constitute 'background principles' that inhere in the title to property interests arising after its enactment." Specifically, the Federal Circuit cited Air Pegasus of D.C. v. United States, 424 F.3d 1206 (Fed. Cir. 2005); American Pelagic Fishing Co v. United States, 379 F.3d 1363, 1379 (Fed. Cir. 2004); Colvin Cattle Co. v. United States, 468 F.3d 803, 807 (Fed. Cir. 2006); Maritrans v. United States, 342 F.3d 1344, 1352 (Fed. Cir. 2003); and M & J Coal Co. v. United States, 47 F.3d 1148 (Fed. Cir. 1995). Notably, each of these cases relies on Lucas, and its

passing reference to Scranton, as the ***sole support*** for the stated proposition. As discussed, the pre-existing limitation at issue in Scranton was one recognized under Michigan law and the citation to its holding in Lucas confirms that "background principles" are created by state law. As such, there is no Supreme Court support for the cited Federal Circuit cases. Additionally, as discussed, these cases directly conflict with the Federal Circuit's *en banc* decision in Presault, which held that federal law is not part of the Lucas "background principles." Given that the Federal Circuit determines most Fifth Amendment takings cases, the Court should use his case to clarify the scope of property rights protected by the Fifth Amendment.

Notably, discussing an issue virtually identical to the one presented here, the Federal Circuit in Presault considered and rejected M & J Coal Co. v. United States, 47 F.3d 1148 (Fed. Cir. 1995), a case relied upon by the Panel, and California Housing Sec., Inc. v. United States, 959 F.2d 955 (Fed. Cir. 1992). These cases were cited "as evidence that federal regulatory law generally modifies state property rights, and renders state-created property rights unenforceable and noncompensable." Presault, 100 F.3d at 1539. Rejecting this view, the Federal Circuit sitting *en banc* held that, in both cases, what was at issue was the reasonableness of the Government's actions in enforcing the law. No taking was found in M & J Coal and California Housing because "no one has a property right to violate the law." Id. at 1539. Thus, the court in Presault rejected the

argument that pre-existing federal law could modify state-created property rights. Despite this binding holding, the Federal Circuit Panel in this case failed to apply it here.

The Federal Circuit also cited Air Pegasus in support of this holding. In Air Pegasus, the court considered a claim that property rights in continued operation of a heliport business were extinguished by Federal Aviation Administration restrictions passed after 9/11. First, the case is distinguishable because it was decided on the exclusive basis that the plaintiff's interests were "frustrated," as opposed to completely eliminated, as here. Id. at 1216. Thus, the court found no Fifth Amendment issue.

In dicta, however, the court went on to opine that the plaintiff could not have asserted an ownership in navigable air space in any case. It noted that "long-standing federal property laws" have precluded private ownership of navigable air space for more than 50 years, and that the Government had always maintained exclusive sovereignty over air spaces. Id. at 1218. The court's opinion was not based on the idea that a single, newly enacted federal statute could redefine ***state property rights***. Rather, the holding was based on the idea that air space had never been subject to private ownership and, thus, no such property interest could have ever existed. Id. at 1217-18. This holding is consistent with Lucas. Because the Government has the exclusive right under federal law to grant property rights in air

space, regulations concerning such federally-created interests did not violate the Fifth Amendment.

The Government below cited Abrahim-Youri, 139 F.3d 1462 (Fed Cir. 1997), in support of its position. In that case, the plaintiffs sought just compensation for the alleged "taking" of their choses in action against Iran by the Government's settlement of their claims with Iran. Id. at 1463. The Federal Circuit explained and extended the Court's ruling in Lucas, holding that because the property rights in question arose "through consensual international transactions," plaintiffs should have anticipated that the Government had the correlative power to restrict such property interests, and that no taking occurred. Id. at 1468. As the property rights at issue were not created under state law, Abrahim-Youri, does not resolve the question now before this Court.

American Pelagic Fishing was also cited by the Federal Circuit below for the proposition that a federal statute can constitute a "background principle" that inheres in the title to the property. However, American Pelagic Fishing, like the other cases relied upon by the Federal Circuit, addressed a federal act that itself was premised upon the historical right of the sovereign, state or federal, to control waters. "The Magnuson Act is consistent with the historical role played by the sovereign, state or federal, with respect to waters." Id. at 379 F.3d at 1379. As early as 1876, the Supreme Court concluded that:

> [t]he principle has long been settled in this Court, that each State owns the beds of all tide-waters within its jurisdiction, unless they have been granted away. In like manner, the States own the tide-waters themselves, and the fish in them, so far as they are capable of ownership while running.

Id. at 379 (quoting McCready v. Virginia, 94 U.S. 391, 394 (1876)). Like the other cases cited by the Federal Circuit below, the property rights at issue in American Pelagic Fishing were not created under state law. The case is therefore distinguishable from the Growers' state-created processor liens that were abrogated by the super-priority statute.

The string of cases cited by the Federal Circuit do not stand for the broad proposition that pre-existing federal law may eliminate interests that "otherwise might be deemed a cognizable property interest" under the Fifth Amendment. Rather, they hold that the Government may, in certain instances, limit property interests that arise by operation of federal law. No cases cited by this Court or the Federal Circuit have held that federal law can limit ***state-law property interests***. In fact, this proposition has been rejected by this Court.

### F. Bankruptcy Cases Construing 11 U.S.C. § 522 Do Not Alter the Outcome Here.

There is a significant difference, with respect to the Bankruptcy power, between property and contract rights. Webber v. Credithrift, 674 F.2d 796, 802 (9th Cir. 1982). In the bankruptcy context, property rights enjoy protection under the Fifth Amendment. United States v. Security Industrial Bank, 459 U.S. 70, 103 S. Ct. 407 (1982); Louisville Joint Stock Land Bank v. Radford, 296 U.S. 555, 55 S. Ct. 854 (1935). On the other hand, Congress is not prohibited from passing laws that impair the obligation of contracts. "In fact, the very essence of bankruptcy law is the modification of contractual obligations." Webber, 674 F.2d at 802; see also Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 188, 22 S. Ct. 857 (1902) (holding that the bankruptcy power "includes the power to discharge the debtor from his contracts)." In contrast to other rights, contracts are made "subject to constitutional power in the Congress to legislate on the subject of bankruptcies." Wright v. Union Central Life Ins. Co., 304 U.S. 502, 516 (1938).

Pursuant to the Contract Clause, federal bankruptcy legislation may permissibly impair a secured creditor's contract rights, thus rendering most bankruptcy legislation constitutional. However, bankruptcy legislation that impacts the secured creditor's ***property interest*** in the collateral must also pass the Fifth Amendment's prohibition against takings. If such legislation

results in a taking of the secured creditor's property rights, just compensation is required.

The Federal Circuit also referenced this Court's decision in United States v. Security Industrial Bank, 459 U.S. 70, 77-78, 103 S. Ct. 407 (1982), in support of its holding that federal law can define the scope of a state-created property interest. In Security Industrial Bank, this Court considered whether retroactive application of Section 522 of the Bankruptcy Code resulted in a taking. In doing so, this Court declined to declare whether either a prospective or retroactive application of Section 522 resulted in a taking. Instead, this Court took a much narrower approach, focusing on whether Congress intended for the retroactive application of Section 522. This Court ultimately held:

> Accordingly, in the absence of a clear expression of Congress' intent to apply § 522(f)(2) to property rights established before the enactment date, we decline to construe the Act in a manner that could in turn call upon the Court to resolve difficult and sensitive questions arising out of the guarantees of the Takings Clause.

Id. at 82.

While this Court did not rule on the prospective application of Section 522, it did reject a contention raised by the Government that ***contract rights***, which are subject to impairment

in bankruptcy, are afforded the same level of Fifth Amendment protection as ***property rights***. The Government made this argument in Security Industrial Bank in an attempt to show that Section 522 was valid and that no taking occurred. In rejecting the Government's position, the Court held that a creditor's contract right to payment is quite different than the creditor's right in the collateral securing the debt:

> It may be readily agreed that § 522(f)(2) is a rational exercise of Congress' authority under Art. I, § 8, cl. 4, and that this authority has been regularly construed to authorize the retrospective impairment of contractual obligations. Such agreement does not, however, obviate the additional difficulty that arises when that power is sought to be used to defeat traditional property interests. The bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation. Thus, however "rational" the exercise of the bankruptcy power may be, that inquiry is quite separate from the question whether the enactment takes property within the prohibition of the Fifth Amendment.
>
> The Government apparently contends that because [prior Supreme Court] cases defined "property" for purposes of the Due Process Clause sufficiently broadly to include rights which at common law would have been deemed contractual, traditional property

> rights are entitled to no greater protection under the Takings Clause than traditional contract rights. It argues that "bankruptcy principles do not support a sharp distinction between the rights of secured and unsecured creditors." ***However "bankruptcy principles" may speak to this question, our cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral.***

Id. at 74-75 (internal citations omitted) (emphasis added).

By making the distinction between contract and property rights in bankruptcy, this Court laid the foundation for the appropriate analysis of whether prospective application of Section 522 constitutes a taking. That is, while Congress' grant of constitutional authority permits it to enact bankruptcy legislation that impairs contracts, it does not authorize Congress to legislatively take property without compensation. Nowhere in its opinion did this Court suggest that Congress could eliminate state-created property rights by enacting bankruptcy legislation. Even if such a holding could be inferred, it would have to be viewed as overruled by Nollan, where the Court rejected the "peculiar proposition" that the Government could alter property rights by making a unilateral claim of entitlement. In effect, if Section 522 is construed

as redefining state property rights, as opposed to limiting contract rights, the Government would have accomplished precisely what Nollan said it could not.

Citing Security Industrial Bank, the Sixth Circuit confirmed the proper takings analysis in a bankruptcy lien case. In American Financial Services v. Nichols, 440 F.3d 850, 854 (6th Cir. 2006), the court recognized that secured creditors have two types of rights: "the *contractual* right to obtain repayment of its debt with a fair rate of return in the form of interest payments and the *property right* the creditor has in the collateral that secures the debt." Id. at 854 (emphasis in original). The Sixth Circuit found that "these two types of rights together constitute the 'bundle of rights' held by the secured creditor." Id. After making this observation, the court held that bankruptcy laws have long been construed to authorize the impairment of contractual obligations. Id. But it also recognized that the power of the bankruptcy laws is limited by the Fifth Amendment. "This distinction creates the also long-recognized tension between permitting the impairment of contractual obligations while maintaining the integrity of property rights." Id.

After making the aforementioned observations, the court in Nichols recounted the Supreme Court's holding in Armstrong, focusing on the fact that there was a "total destruction" of the subcontractor's liens and that the liens were compensable property subject to taking and not a

"mere consequential incidence" of a valid regulatory measure. Nichols, 440 F.3d at 84. The court then held:

> While the bankruptcy laws allow interference with contractual arrangements and some diminution of property rights, if the interference goes so far as to constitute "total destruction" of the value of the property held by a creditor, it violates the *Fifth Amendment* and may not stand.

Id. (emphasis in original).

Nichols confirms that whether it be bankruptcy legislation (Security Industrial Bank) or sovereign immunity (Armstrong), when a creditor's ***property interest*** in the collateral, as opposed to their contractual right to repayment, is "totally destroyed," there is a compensable taking. This is entirely consistent with the rationale of Security Industrial Bank and the cases cited above discussing the Government's inability to redefine state-created property rights.

### G. The Federal Circuit Erred in Using Pre-emption to Justify the Taking of the Growers' Liens.

The Federal Circuit held that the Growers' state-law liens were "preempted to the extent that they could not and did not grant appellants any compensable property interest at the time of the lien enforcement above the government's super-

priority lien interest based upon federal law." This is in direct conflict with this Court's holding in Monsanto and the Federal Circuit's *en banc* decision in Presault.

This Court has expressly held that actions within the Government's power are still subject to the Takings Clause. See Kaiser Aetna, 444 U.S. at 174 ("There is no question but that Congress can assure the public a free right of access....Whether a statute or regulation that went so far exacted a taking, however, is an entirely separate question.").

In Monsanto, this Court rejected the same lien priority argument based upon preemption currently made by the Government:

> EPA encourages us to view the situation not as a taking of Monsanto's property interest in the trade secrets, but as a 'preemption' of whatever property rights Monsanto may have had in those trade secrets. . . . ***Thus, it is said, the Supremacy Clause dictates that the scheme not vary depending on the property law of the State in which the submitter is located. This argument proves too much. If Congress can preempt state property law in the manner advocated by EPA, then the Taking Clause has lost all vitality.*** This Court has stated that a sovereign, by ipse dixit, may not transform private property into public property without compensation. This is the very kind of thing that the Taking

> Clause of the Fifth Amendment was meant to prevent.

Id. (emphasis added). Thus, although the Government is within its rights under certain circumstances to establish lien priority, such actions are still subject to the Fifth Amendment.

The Federal Circuit sitting *en banc* in Presault also rejected the preemption holding rendered by the Federal Circuit panel in this case. There, the court recognized that the federal government has power to preempt state-created property rights: "However, as Justice O'Connor succinctly pointed out in her concurring opinion, having and exercising the power of preemption is one thing; being free of the Constitutional obligation to pay just compensation for the state-created rights thus destroyed is another." Presault, 100 F.3d at 1537 (citing Presault II, 494 U.S. 1, 22, 110 S.Ct. 914 (1990)).

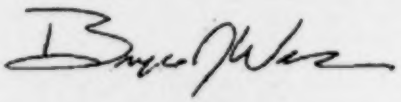
## CONCLUSION

This Court should accept review of this matter to clarify that property rights created pursuant to state law cannot be prospectively eliminated by federal legislation. This Court's action is required to prevent Congress from legislating around the Takings Clause, as it attempted to do in this case, by redefining what constitutes "property" for purposes of the Fifth Amendment. As part of its

analysis, the Court should confirm that the "background principles" of law referred to in Lucas do not include federal legislation. The Court should also hold that use of the super-priority statute to "preempt" the Growers' state-created lien rights is a compensable taking under the Fifth Amendment.

DATED: June 30, 2008

Respectfully submitted,



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*Attorneys for Petitioners*

## APPENDIX A

**United States Court of Appeals for the Federal Circuit**

2007-5049

ROSS L. BAIR, LYLE K. BAIR, BAIR BROTHERS, BAIR FARMS, INC., BERGESON FARMS, INC., CEEKAYDEE FARMS GENERAL PARTNERSHIP, KEITH B. CHILD, CORBETT DRAW FARMS GENERAL PARTNERSHIP, D & D GILBERT FARMS, INC., TOM DOWNS, J. LAMAR GILBERT, DAVID HAMMOND, JERRY HODGES, CHRIS HYER, JOHN HYER, MARK IVERSON, L. SHEFFELS & SONS, INC., LEON R. BAKER FARMS, LLC, JERRY C. MILBRANDT, R & J FAMILY FARMS, INC., ALLAN ROBEL, RONALD ROYLANCE FARMS, INC., ROYLANCE COULEE PARTNERSHIP, RANDY ROYLANCE, SBS FARMS, LLC, TRAVIS STEFFLER, PAUL STOKER, STOKROSE FARM AND FEEDLOT, TIM TAYLOR, TRACY LYBBERT FARMS, INC., DUANE MARCUSEN, LUIS A. MARTINEZ, FRANK MARTINEZ, LEGACY FARMS, INC., SHANE CHRISTENSEN, J. LYN WOOD, PIERCY FARMS, INC., AG CAPITAL COMPANY, KEVIN JENKS, ROGER ROYLANCE FARMS, INC., LARRY SCHAAPMAN, DAVID EDLER, CIRCLE D, INC., DIAMOND M, INC., D. GLEN BAIR, and WASHINGTON STATE DEPARTMENT OF NATURAL RESOURCES,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Bryce J. Wilcox, Lukins & Annis, P.S., of Spokane, Washington, argued for plaintiffs-appellants.

Steven M. Mager, Attorney, Commercial Litigation Branch, Civil Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With him on the brief were Peter D. Keisler, Assistant Attorney General, Jeanne E. Davidson, Director, and Mark A. Melnick, Assistant Director. Of counsel was Gregory T. Jaeger, Attorney.

Appealed from: United States Court of Federal Claims

Judge Lawrence M. Baskir

Appeal from the United States Court of Federal Claims in consolidated case 04-CV-1689, with 04-CV-1846, 04-CV-1847, 04-CV-1848, 04-CV-1849, 04-CV-1850, 04-CV-1851, 04-CV-1852, 04-CV-1853, 04-CV-1854, 04-CV-1855, 04-CV-1856, 04-CV-1857, 04-CV-1858, 04-CV-1859, 04-CV-1860, 04-CV-1861, 04-CV-1862, 04-CV-1863, 04-CV-1864, 04-CV-1865, 04-CV-1866, 04-CV-1867, 04-CV-1868, 04-CV-1869, 04-CV-1870, 04-CV-1871, 04-CV-1872, 04-CV-1873, 04-CV-1874, 04-CV-1875, 04-CV-1876, 04-CV-1877, 04-CV-1878, 04-CV-1879, 04-CV-1880, 04-CV-1881, 04-CV-1882, 04-CV-1883, 04-CV-1884, 04-CV-1885, 04-CV-1886, 04-CV-1887, 04-CV-1888, 04-CV-1889, and 04-CV-1891, Judge Lawrence M. Baskir.

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DECIDED: February 5, 2008

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Before LINN, DYK, and MOORE, Circuit Judges.

DYK, Circuit Judge.

This case involves a takings claim. The alleged taking resulted from the Commodity Credit Corporation's ("CCC") enforcement of its super-priority lien interest in sugar produced from sugar beets under 7 U.S.C. § 7284(d) (2000). Appellants Ross L. Bair, et al. ("appellants") are sugar beet growers whose state-law liens on the sugar were rendered valueless by the enforcement of CCC's super-priority lien. They appeal from the decision of the United States Court of Federal Claims granting summary judgment in favor of the government. Because we conclude that the Court of Federal Claims correctly determined that there was no taking, we affirm.

## BACKGROUND

Appellants are producers of sugar beets in Washington state. They contracted with processor Pacific Northwest Sugar Company ("PNSC") to process their 2000 sugar beet crop into refined beet sugar. The beets were delivered for processing. Payment for the beets was to occur over the course of several months, but PNSC only made the first 55% of those payments. Under Washington law, upon delivery of an agricultural product to a processor, "the producer has a first priority statutory lien, referred to as a 'processor lien.'" Wash. Rev. Code. § 60.13.020 (2007). This lien "attaches to the agricultural products . . . delivered, to the processor's or conditioner's inventory, and to

the processor's or conditioner's accounts receivable." Id. Appellants delivered their beets to PNSC on or before December 1, 2000, and therefore had state statutory processor liens that attached by that date. Both parties agree that the liens gave appellants a lien on the sugar beets, the sugar refined from those beets, and any proceeds from the sale of that sugar. If PNSC failed to make a payment under the contract, appellants were entitled to foreclose and enforce the lien by a civil action in state court. See id. § 60.13.070 ("The processor . . . liens may be foreclosed and enforced by civil action in superior court.").

The CCC, an agency of the United States within the Department of Agriculture, makes loans to sugar beet processors in order to provide price support to the domestic sugar market. Between October 10, 2000, and February 12, 2001, the CCC issued twenty-one nonrecourse loans to PNSC. Upon making these loans, the CCC acquired a security interest in the refined sugar produced by PNSC from appellants' beets. Appellants' state processor liens, which attached upon delivery of the beets and later attached to the sugar produced from the beets, necessarily predated the later CCC loans, which were secured by the sugar refined from those beets. Nonetheless, the CCC's loans received super-priority over appellants' loans under 7 U.S.C. § 7284(d), which provides:

> A security interest obtained by the Commodity Credit Corporation as a result of the execution of a security

> agreement by the processor of fsugarcane or sugar beets shall be superior to all statutory and common law liens on raw cane sugar and refined beet sugar in favor of the producers of sugarcane and sugar beets and all prior recorded and unrecorded liens on the crops of sugarcane and sugar beets from which the sugar was derived.

On March 5, 2001, after paying about half of what it owed to appellants, PNSC defaulted on its agreement with them. After this default by PNSC, appellants timely filed statements evidencing their processor liens on March 22, 2001. See Wash. Rev. Code. § 60.13.050 (requiring producers to file liens within twenty days of payment due date in order to maintain priority over earlier-filed liens and perfected security interests). On September 19, 2001, appellants brought suit in Washington state court, against both PNSC and CCC, seeking foreclosure of those liens and recovery of $8,714,690.

The government removed this action to the United States District Court for the Eastern District of Washington. The district court granted summary judgment in favor of the CCC because it concluded that the plain language of 7 U.S.C. § 7284(d) afforded super priority to the CCC's liens. Bair v. Pac. Nw. Sugar Co., No. CS-01-0310, slip op. at 24 (E.D. Wash. Feb. 21, 2002) (unpublished), aff'd, 85 F. App'x 555 (9th Cir. 2004) (not selected

for publication in the Federal Reporter). As a result of these rulings, the CCC was able to recover $4,540,803 of its outstanding loans, through a combination of the remaining processed sugar and the proceeds from its sale, and wrote off $10,411,089 of PNSC's debt. No sugar or proceeds remained to pay PNSC's debt to appellants, and their liens were rendered worthless.

On November 19, 2004, appellants filed a complaint in the United States Court of Federal Claims, alleging that the application of 7 U.S.C. § 7284(d) constituted a taking under the Fifth Amendment. The Court of Federal Claims determined that "[t]he Federal statute created a pre-existing limitation on the property rights that the Growers could acquire under state law." Bair v. United States, No. 04-CV-1689, slip op. at 10 (Fed. Cl. Jan. 11, 2007). The court therefore held that the application of that statute did not constitute a taking, and granted summary judgment in favor of the government. Id. at 12.

Appellants timely appealed. . We have jurisdiction pursuant to 28 U.S.C. § 1295(a)(3).

## DISCUSSION

We review the Court of Federal Claims's decision to grant summary judgment without deference. Old Stone Corp. v. United States, 450 F.3d 1360, 1367 (Fed. Cir. 2006).

The Supreme Court has recognized two types of regulatory takings—categorical regulatory takings and partial regulatory takings. If a partial regulatory taking is alleged, we must undertake the fact-based inquiry set out by the Supreme Court in Penn Central Transportation Co. v. New York City, 438 U.S. 104 (1978). The Supreme Court has identified several relevant factors that have particular significance, including: (i) "the character of the governmental action"; (ii) "[t]he economic impact of the [action] on the claimant"; and (iii) "the extent to which the [action] has interfered with distinct investment-backed expectations." Id. at 124. If a categorical regulatory taking is alleged, we ask only whether the regulatory imposition is one that "denies all economically beneficial or productive use of [the property]." Lucas v. South Carolina Coastal Council, 505 U.S. 1003, 1015 (1992); see also Maritrans Inc. v. United States, 342 F.3d 1344, 1353 (Fed. Cir. 2003). Appellants contend that such a categorical taking occurred here because their liens were rendered valueless by the government's foreclosure on the CCC liens and consequent enforcement of its statutory super-priority right, which left no collateral or proceeds from which the appellants' liens could be satisfied.

We assume without deciding that the correct date from which to judge whether a taking occurred is, as appellants contend, the date on which the government asserted its super-priority interest against the appellants and that this action rendered their property valueless. However, under either type of alleged regulatory taking (categorical

or partial), before we undertake a Penn Central or Lucas analysis, we must determine as a threshold matter whether the claimant has established a property interest for purposes of the Fifth Amendment. See Members of the Peanut Quota Holders Ass'n v. United States, 421 F.3d 1323, 1330 (Fed. Cir. 2005); Am. Pelagic Fishing Co. v. United States, 379 F.3d 1363, 1372 (Fed. Cir. 2004); Maritrans Inc., 342 F.3d at 1351. In other words, we ask "whether the claimant possessed a 'stick in the bundle of property rights.'" Adams v. United States, 391 F.3d 1212, 1218 (Fed. Cir. 2004) (citation omitted). "It is axiomatic that only persons with a valid property interest at the time of the taking are entitled to compensation." Wyatt v. United States, 271 F.3d 1090, 1096 (Fed. Cir. 2001). Once the claimant has identified a valid property interest, we must determine whether the challenged governmental action constituted a compensable taking of that property interest. See Am. Pelagic, 379 F.3d at 1372.

The central dispute in this case is whether appellants possessed a compensable property interest in their right to lien priority over the CCC's liens on PNSC's refined sugar. The Supreme Court in Lucas made dear that property interests are acquired subject to "background principles" of law, and that limitations on property rights that otherwise would effect a categorical taking are permissible if they "inhere in the title itself." 505 U.S. at 1029. The parties do not dispute that, under Washington law, appellants' interests were created in 2000, with the last date of creation being

December 1, 2000. At that time both state law and federal law existed purporting to define the priority of the appellants' liens.

Appellants argue, however, that only the states, and not the federal government, have the power to create and define property rights, and that the federal statute therefore cannot constitute a "background principle" of law in derogation of appellants' state-created right to lien priority.[4] We reject appellants' argument.

We first note that the Supreme Court has held that federal law determines what constitutes "property" for purposes of applying federal statutes. In particular, the Court has made clear that "the priority of liens stemming from federal lending programs must be determined with reference to federal law." United States v. Kimbell Foods, Inc., 440 U.S. 715, 726 (1979); see also United States v. Craft, 535 U.S. 274, 278-79 (2002) ("State law determines only which sticks are in a person's bundle. Whether those sticks qualify as 'property' for purposes of the federal tax lien statute is a question of federal law.").

Despite the statements in a number of Supreme Court cases referring to the creation of

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[4] Appellants "maintain that property rights are created and defined by state law, and such rights cannot be abridged by federal legislation, for if this was the case, Congress could effectively legislate around the Takings Clause. This point of disagreement is the sole issue on appeal." Br. of Plaintiffs-Appellants at 23.

property interests by state law, the Court has recognized that state-created property interests may be limited by federal laws, even in the area of real property. In Lucas itself, the Supreme Court recognized that federal law can constitute a "background principle" for purposes of categorical takings. For example, the Lucas majority approvingly cited Scranton v. Wheeler, 179 U.S. 141 (1900), 505 U.S. at 1029. There the Court held that the construction of a pier by the federal government, which destroyed a riparian owner's access to navigable waters, did not effect a taking because the riparian owner's title "was acquired subject to the rights which the public have in the navigation of such waters." Scranton, 179 U.S. at 163.

In cases of personal property, the background principles are defined by the law existing at the time that the property came into existence. Any lawful regulation defining the scope of the property interest that predates the creation of that interest will "inhere in the title" to the property.[5]

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[5] We also have made clear that, in the second step of the takings analysis, the "distinct investment-backed expectations" factor of the Penn Central test is to be judged at the time the personal property was acquired. See Commonwealth Edison Co. v. United States, 271 F.3d 1327, 1350 & n.22 (Fed. Cir. 2001) (citing Palazzolo v. Rhode Island, 533 U.S. 606, 633-34 (2001) (O'Connor, J., concurring)); see also Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1006 (1984). The question whether the Penn Central test has been satisfied, however, is separate from the question of whether a property interest exists in the first place.

For example, in the bankruptcy context, the Supreme Court has strongly suggested that 11 U.S.C. § 522(f)(2), which permits debtors in bankruptcy proceedings to avoid liens on certain property, can limit the extent of a lienholder's interest in such property after the enactment of the statute. See United States v. Sec. Indus. Bank, 459 U.S. 70 (1982). In the absence of clear congressional intent, the Court refused to construe the statute to apply retroactively because such an interpretation would require the Court to face "difficult and sensitive questions" arising out of the Takings Clause. Id. at 82. The Court found no such difficulty with prospective application of the statute, despite its effect on lien interests that might later be created under state law. Our sister circuits have specifically held that prospective application of section 522(f) does not create takings liability. See In re Weinstein, 164 F.3d 677, 686 (1st Cir. 1999) ("[A]t its inception, the lien was subject to and limited by the debtor's power to avoid the lien under § 522(f)."); In re Thompson, 867 F.2d 416, 422 (7th Cir. 1989) (lien avoidance under federal bankruptcy statute "is not a taking when it is authorized before the creditor makes the secured loan in question"); In re Leicht, 222 B.R. 670, 682-83 (B.A.P. 1st Cir. 1998).

The Armstrong case, heavily relied on by the appellants here and discussed below, reached a similar conclusion. Armstrong v. United States, 364 U.S. 40 (1960). There the petitioners provided materials to a private contractor for use in the

construction of a Navy ship, and obtained liens on those materials under state law. Pursuant to 34 U.S.C. § 582,[6] the government later made progress payments and was entitled to a "paramount" lien on the work done on account of each payment. The Court made clear that the enforcement of the government lien for progress payments did not result in a taking, because the petitioners' property interest was limited to "whatever proceeds the property might bring over and above the Government's claim to the amount of its progress payments." Id. at 45. The federal statute thus limited the petitioners' later-arising,. state-created property interests, even though the state liens arose before the progress payments were made[7] and the enforcement of the federal statute reduced the value of the state liens.

In other contexts our own cases have recognized that a federal statute or authority can

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[6] This statute, later codified at 10 U.S.C. § 7521 and subsequently repealed in 1994, Federal Acquisition Streamlining Act of 1994, Pub. L. No. 103-355, § 2001(j), 108 Stat. 3243, 3303, provided authorization to the Secretary of the Navy "to make partial payments from time to time during the progress of the work under all contracts made under the Navy Department for public purposes, but not in excess of the value of work already done," and stated that such contracts "shall provide for a lien in favor of the Government, which lien is made paramount to all other liens, upon the articles or thing contracted for on account of all payments so made." 34 U.S.C. § 582 (1952).

[7] See Br. for the Pars at 10, Armstrong, 364 U.S. 40.

constitute a "background principle" that inheres in the title to property interests arising after its enactment, therefore precluding a takings claim based on the application of the statute to those property interests. See, e.g., Air Pegasus of D.C., Inc. v. United States, 424 F.3d 1206, 1218 (Fed. Cir. 2005) (federal government's longstanding exercise of "dominant control over the navigable airspace" limited property rights in use of that airspace); Am. Pelagic, 379 F.3d at 1379 (Magnuson Act was a background principle that inhered in after-acquired title to vessel and thus limited rights to uses of vessel contrary to the Act); M & J Coal Co. v. United States, 47 F.3d 1148, 1154 (Fed. Cir. 1995) (Surface Mining Control and Reclamation Act of 1977 limited company's right to mine under state permit issued after enactment of federal statute).[8]

Here there can be no question of the authority of the federal government to make loans to sugar processors. The loans provided by the CCC to processors like PNSC are part of a federal program designed to stabilize and support the domestic sugar market. Loans from the CCC to processors of domestic sugar beets are a major component of this program. Federal regulations

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[8] See also Ruckelshaus, 467 U.S. at 1003-04; Colvin Cattle Co. v. United States, 468 F.3d 803, 807 (Fed. Cir. 2006); Maritrans, 342 F.3d at 1352 (noting that "'background principles' derived from an independent source, such as state, federal, or common law, define the dimensions of the requisite property rights for purposes of establishing a cognizable taking" (emphasis added)).

guarantee that the loan proceeds will be used to make certain minimum payments to sugar beet producers, like appellants, who provide beets for processing. 7 C.F.R. § 1435.104(c). The loan proceeds therefore benefit both processors and growers, and support the national sugar industry in general. There is also no doubt as to the federal government's authority to obtain and enforce security of the federal loans. See Kimbell Foods, 440 U.S. at 726. As the Supreme Court has explained, "state law is naturally preempted to the extent of any conflict with a federal statute." Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 372 (2000). The federal statute, guaranteeing super-priority for the CCC loans to PNSC, and the state statute, guaranteeing first priority for the appellants' processor liens in the sugar refined by PNSC, clearly are in direct conflict. Because the federal statute legitimately altered the priority of liens arising after the statute was enacted, it preempted state law to the contrary.

To be sure, takings questions may arise where the federal statute has a retroactive effect. For example, as noted above, in Security Industrial Bank the Court stated that if it construed section 522(f), permitting debtors to avoid liens on certain property, to apply retroactively, it would "call upon the Court to resolve difficult and sensitive questions arising out of the guarantees of the Takings Clause." 459 U.S. at 82 (internal quotation marks omitted). Similarly, in Preseault v. United States, 100 F.3d 1525 (Fed. Cir. 1996), we rejected the government's argument that the property

interests could be defined "by the evolving enactment and implementation of federal railroad law" after the creation of the property rights in question. Id. at 1537 (emphasis added). "[B]road general legislation authorizing a federal agency to engage in future regulatory activity," id. at 1538, did not effectively limit the property right.[9]

However, this is not a situation in which a federal statute restricting the state lien was enacted after the state property interest came into existence. Beginning in 1977, Congress amended the Agricultural Act of 1949, Pub. L. No. 81-439, 63 Stat. 1051, to provide price support to the sugar industry through loans made to processors of sugar beets in certain crop years. See Food and Agriculture Act of 1977, Pub. L. No. 95-113, § 902, 91 Stat. 913, 949 (providing loans for 1977 and 1978 crop years). In 1991, Congress added a provision ensuring the super-priority of CCC loans to sugar processors over statutory and common law producer liens. See Food, Agriculture, Conservation, and Trade Act Amendments of 1991, Pub. L. No. 102-237, § 111(b), 105 Stat. 1818, 1830. In 1996, the Agricultural Market Transition Act reauthorized sugar beet processor loans, and again provided for the super-priority of the federal loans

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[9] In Lucas, the Supreme Court indicated that, as to personal property, even retroactive application of a statute might permissibly alter a state-created property interest. See 505 U.S. at 1027-28 ("[I]n the case of personal property, by reason of the State's traditionally high degree of control over commercial dealings, [the owner] ought to be aware of the possibility that new regulation might even render his property economically worthless . . .").

over statutory and common law liens in favor of sugar beet producers. See Pub. L. No. 104-127, tit. 1, §§ 156(b), 164(d), 110 Stat. 896, 931, 935-36.[10] This act was in effect in December 2000, when appellants' state liens attached. Contrary to appellants' argument, the fact that the statute only had an effect in this case after the state lien was created is irrelevant. The federal statutory limit existed long before that time, and its later application does not create a retroactivity problem.

Appellants finally argue that other cases support their argument that a federal statute may not alter property interests created by state law. These cases are all distinguishable. In each case, the state-created property interest was rendered unenforceable not by operation of a preexisting federal statute but as a consequence of sovereign immunity. In Armstrong, materials on which the plaintiffs held state-law liens were transferred to the United States by operation of a contract to which the plaintiffs were not a party. 364 U.S. at 46-47. As a result, "the liens were still valid, but they could not be enforced because of the sovereign immunity of the Government and its property from

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[10] The 1996 Act also suspended, for the 1996 through 2002 crop years, 7 U.S.C. § 1421(e)(2)(a), a provision that had guaranteed payment by the government to sugar beet producers whose liens were not paid in full because of the insolvency of the processor. Agricultural Market Transition Act § 171(b)(1)(J), 110 Stat. at 937. Appellants allege that, prior to 1996, section 1421(e)(2)(a) had provided "just compensation" for what they claim would otherwise have been an unconstitutional taking.

suit." Id. at 46 (internal citation omitted). In both Shelden v. United States, 7 F.3d 1022 (Fed. Cir. 1993) and United States v. Metmor Financial, Inc. (In re Metmor Financial, Inc.), 819 F.2d 446 (4th Cir. 1987), title to property on which the plaintiffs held mortgage lien interests was transferred to the government under forfeiture provisions of federal criminal statutes. In these cases, sovereign immunity prevented the mortgage holders from enforcing their interests against the United States. See Shelden, 7 F.3d at 1030; Metmor, 819 F.2d at 450. Thus "transfer . . . altered, not the lien itself, but its enforceability? Metmor, 819 F.2d at 450. Similarly, in Murray v. United States, 817 F.2d 1580 (Fed. Cir. 1987), the United States acquired property through a tax lien foreclosure, and refused to allow mortgage holders to redeem the property. Id. at 1582. The mortgage holders were unable to bring suit against the government based on this refusal because of sovereign immunity. Id. In each of these cases the assertion of the defense of sovereign immunity was held to create a taking; none of the cases held that a federal statute limiting property interests created under state law and enacted before the property came into existence constituted a taking of those interests. To the contrary, as noted above, in Armstrong the Supreme Court specifically recognized that the enforcement of a superior government lien for progress payments, arising under a preexisting federal statute, and the consequent reduction in value of the plaintiffs' liens, did not result in a taking. 364 U.S. at 45. The Court held only that plaintiffs were entitled to recover the value of their

state-law liens remaining after the enforcement of the government liens. Id.

In summary, the background principles of law at the time appellants' liens were created therefore provided for super-priority of CCC's security interest over "all statutory and common law liens on . . . refined beet sugar in favor of the producers." 7 U.S.C. § 7284(d). State law provisions to the contrary were preempted to the extent that they could not and did not grant appellants any compensable property interest at the time of lien enforcement above the government's super-priority lien interest based on federal law. Because we hold that appellants had no compensable property interest in the priority of their state-created liens, we need not address the second step of the takings analysis—namely, whether the government action in fact resulted in any categorical or partial taking of a property interest.

## CONCLUSION

For the foregoing reasons, the judgment of the Court of Federal Claims is

## AFFIRMED.

## COSTS

No costs.

**APPENDIX B**

**In the United States Court of Federal Claims**

Case No. 04-1689C (CONSOLIDATED)
(FILED: January 11, 2006)
TO BE PUBLISHED

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**Cohen**, Director, and **Peter D. Keisler**, Assistant Attorney General.

**Michael E. Trow**, Office of General Counsel, Department of Agriculture, Portland, OR, Of Counsel for Defendant.

**Arielle Cohen**, law clerk.

## OPINION

**BASKIR, Judge.**

This case involves an alleged taking without compensation in violation of the Fifth Amendment. The Plaintiffs ("Growers") claim they have state law liens on the crop of sugar beets delivered in 2000 to Pacific Northwest Sugar Company, LLC ("PNSC"). The Commodity Credit Corporation ("CCC") has a superior interest in the same sugar as a result of PNSC's utilization of a Federal program that provides loans to beet processors in exchange for a "super-priority" security interest in sugar inventory. The Growers' state law liens on 2000 crop year sugar attached before PNSC entered into the loan agreements secured by the same sugar. The Growers claim that the application of the super-priority loan provision, 7 U.S.C. § 7284(d), destroys the value of their now subordinated liens and constitutes an uncompensated taking. The Government argues that the provision operated as a pre-existing limitation on the property rights that the Growers could acquire. The case is before us on cross motions for summary judgment.

The Federal statute at issue here speaks directly to the priority of security interests, one of the statutorily defined property rights that make up a lien. We find that the statute altered the nature of the processor liens from their inception. **The Plaintiffs' Motion for Summary Judgment is DENIED, and the Defendant's Cross Motion is GRANTED.**

## Background

### I. The Sugar Beet Industry

The background provided here represents the Court's synthesis of information found in the Parties' submissions and the legislative history of the Agriculture Market Transition Act (Pub. L. No. 104-127, Title I, 110 Stat. 896 (1996)). Although it is helpful to an understanding of the context of this case, this information is not material to the holding. A dispute regarding these background facts would not preclude summary judgment.

#### A. Sugar Beet Farming

The sugar beet "crop year" begins with the harvest in September, October and November. Beets are delivered to processing factories as they are harvested. Sugar beets are perishable, so processing must take place as rapidly as possible. From mid-September until mid-February, factories run full-tilt to convert the beets into refined sugar, or at least into less perishable intermediate stages of syrup. The urgency is reflected in the

terminology: this period is called the sugar beet "campaign."

Storage capacity at sugar processing factories is very limited. Processors do not have the ability to hold onto inventory and wait for favorable market conditions. They must sell the majority of each year's sugar as it is processed, frequently on 3, 6, or 12 month forward sales contracts that lock in low prices.

B. Federal Sugar Policy

American involvement in the sugar trade predates the Constitution. Some of the best known New England families owe their fortunes to rum smuggling, viewed as a patriotic protest to the British Parliament's 1733 Molasses Act and 1763 Sugar Act. Rum Trade, Dictionary of American History, Volume VI at 170 (Charles Scriber's Sons, rev. ed., 1976). The Federal Government has been tinkering with the sugar market since the First Congress imposed a tariff on imported sugar in 1789. 1 Stat. 24, 25. Loans to processors (described below) were first used as a means of supporting the industry in 1977. Food and Agriculture Act of 1977, Pub. L. No. 95-113, Title IX, § 902, 91 Stat. 913, 949. This dispute arises against the background of reforms to the sugar support program made in the Agriculture Market Transition Act (Pub. L. No. 104-127, Title I, 110 Stat. 896 (1996)) in response to concerns about excessive government intervention and inflated prices. See 142 Cong. Rec. 2503-2509 (Senate debate regarding extension of the sugar program);

142 Cong. Rec. 3152-3164 (House debate regarding phase-out of the sugar program).

In the 1996 Act, Congress made several changes to the sugar program that had a destabilizing impact on the market. Historically, the Secretary of Agriculture had two tools to control supply in the sugar industry and keep prices high enough to prevent loan forfeiture: the tariff-rate quota program to control imports and marketing allotments authority to control domestic production. The Secretary's control over imports is limited because of international treaty obligations. The 1996 reforms eliminated the remaining tool, market allotments. Pub. L. No. 104-127, Title I, § 171(a)(1)(E), 110 Stat. 937. This led to extensive instability in the sugar market and a glut of supply. The price for wholesale beet sugar dropped to its lowest level in 22 years in late 1999 and early 2000. More than 25% of the beet or cane processing facilities operating in 1996 shut down between 1996 and 2001. Testimony of the American Sugar Alliance to the U.S. Department of Agriculture, March 12, 2003, available at www.fsa.gov/ao/epaskIsa/USDA_Policy_Implemt_Roney_031203.pdf. Congress restored the Secretary's marketing allotments authority in the 2002 Farm Bill. 7 U.S.C. § 1359bb, Pub. L. No. 107-171, Title I, § 1403, 116 Stat. 188.

The 1996 reforms also suspended 7 U.S.C. § 1421, which provided for direct payments from the government to growers in the event of producer default due to insolvency. Pub. L. No. 104-27, Title I, § 171(b)(1)(J), 110 Stat. 937. Prior to 1996, sugar

beet producers who were not paid in full by processors were guaranteed payment of at least the price support level established by the Secretary. The Growers argue that before its suspension, § 1421 provided compensation for the taking worked by 7 U.S.C. § 7284(d), the super-priority provision that is the subject of this case. In their brief, the Growers assert that § 1421 was suspended only from 1996-2002. Pls.' Rep. and Resp. at 2 n.1. This is not correct. The suspension of § 1421 remains in effect for the 2002-2007 crop years. Pub. L. No. 107-171, Title I, § 1602(b)(10), 116 Stat. 213.

C. CCC Loans

A major component of Federal support of the sugar industry (beet and cane) is a loan program made available to processors through the Commodity Credit Corporation. The terms of the loan program in effect for the crop years 1996-2002 are summarized below and are codified at 7 C.F.R. §§ 1435.100-1435.111 (1999).

Sugar loans become available on October 1 of the crop year. Loans mature on the earlier of September 30 or the last day of the ninth month after the loan is made. The average national loan rate is set by Federal statute at $22.90 per hundredweight of sugar (7 U.S.C. § 7272 (1996)) and adjusted for local conditions by state and county offices of the Farm Service Agency. Processors pledge refined sugar from domestically grown and processed beets as security. The CCC's super-priority interest in the sugar and crops,

which the Plaintiffs here allege works a taking, is provided in 7 U.S.C. § 7284(d):

> A security interest obtained by the Commodity Credit Corporation as a result of the execution of a security agreement by the processor of sugarcane or sugar beets shall be superior to all statutory and common law liens on raw cane sugar and refined beet sugar in favor of the producers of sugarcane and sugar beets and all prior recorded and unrecorded liens on the crops of sugarcane and sugar beets from which the sugar was derived.

Processors have two options upon maturation of a loan. They may redeem the sugar held as collateral by paying off the loan (and then sell the sugar on the market), or they may forfeit the loan and turn over title to the sugar to the CCC. In the latter case, processors effectively sell the sugar to the government at the loan rate of $22.90 per hundredweight, less a small forfeiture penalty. Upon forfeiture, the CCC takes title to the sugar collateral, but the sugar remains in the processors' facilities.

In theory, the loan rate acts as a guaranteed floor price for sugar processors. However, limited storage capacity combined with poor market conditions can push processors into debt to the CCC. If a processor has loans on a larger quantity of sugar than it has room to store, it must sell it at

the market price. The proceeds of sale will be insufficient to pay back the CCC loans secured by the same quantity of sugar, leaving the processor with insufficient sugar or proceeds to satisfy all of its CCC loans.

II. Washington State Processor Liens

Washington state law grants producers of raw agricultural products "processor liens" attaching to the delivered products and the assets of defaulting, processors. Wash. Rev. Code § 60.13.020. The liens are created automatically and continue without filing requirements for twenty days after payment by the processor is due and remains unpaid. Id. The date of attachment is retroactive to the date of delivery of the agricultural products to the processor. Id. In order to preserve the lien, and the retroactive attachment to the delivery date, producers must file an official lien statement within the twenty-day period. Wash. Rev. Code §§ 60.13.040, 60.13.050.

It is important to note that although the Washington statute refers to processor liens as "first priority statutory liens," this nomenclature is misleading. If the producer fails to officially file within the twenty-day period, the liens are subordinate to perfected security interests and to any other liens attaching prior in time. Even if the producer officially files within the twenty-day period, the liens are still subordinate to liens for taxes or labor perfected before the filing. Wash. Rev. Code § 60.13.050. Within the hierarchy of

state law, therefore, processor liens are actually third in priority.

III. Plaintiffs' Beets and the CCC Loans

The following facts are drawn from the Parties' Consolidated Statement of Uncontroverted. Facts.

The Growers are 46 sugar beet farmers in the state of Washington. Most, if not all, are members of a growers' cooperative founded in 1991 called the Columbia River Sugar Company ("CRSC"). CRSC and a major sugar processing company, Holly Northwest, formed a limited partnership to build and operate a beet processing plant in Moses Lake, Washington. CRSC controlled 57% of the partnership. Prior to the completion of the factory, the Growers delivered their sugar beets to processors in California and Idaho. Upon its completion in 1998, Growers delivered their beets to the Moses Lake factory.

The 1998 campaign at Moses Lake was a failure to such an extent that over 300,000 tons of beets spoiled before they could be processed. Holly Northwest wanted to terminate its involvement, so CRSC formed a limited liability company, PNSC, which bought out Holly's interest in the factory. CRSC was and is the sole member of PNSC.

The Growers entered into an agreement for the 1999-2003 crop years to deliver their beets to CRSC, which in turn would sell them to PNSC for processing. The 1999 crop year beets were

delivered and processed into sugar that was used as collateral for CCC loans. Because wholesale sugar prices were low in 1999, PNSC forfeited the loans. CCC therefore took title to approximately 53.7 million pounds of sugar that remained in storage at the factory.

In 2000, the Growers individually entered "Beet Purchase Agreements" directly with PNSC to grow and deliver beets, suspending the 1999-2003 agreement whereby CRSC acted as the middleman. The Beet Purchase Agreements provided for delivery of all beets by December 1, 2000. PNSC was to make incremental payments to growers of 25% of the contract price on December 5, 2000, 15% on the fifth day of each of the months of January, February, March and April 2001 and the remaining 15% on or before October 25, 2001.

All of the Growers' beets were delivered by December 1, 2000. The incremental payments were made in December, January and February, totaling 55% of the contract price. The March payment was not made. Within twenty days of nonpayment, the Growers followed the appropriate filing procedures to preserve their processor liens under Washington law.

Between October 10, 2000 and February 12, 2001, the CCC made 21 nonrecourse loans to PNSC. The loan rate applicable in the region was $22.08 per hundredweight. The value of the 21 loans totaled $32,051,755.68. The CCC only accepts refined sugar, not beets, as collateral, so loans were made as sugar was refined. For each

batch of sugar, the Growers' processor liens, which attached on the date of beet delivery pursuant to state law, necessarily predated CCC loans secured by that sugar.

As discussed above, the sugar industry faced challenging economic conditions in 2000. There are also indications in the record that PNSC's limited storage capacity was further reduced because it was already storing large quantities of sugar forfeited to CCC for 1999 loans. For these or other reasons, PNSC could clear only some of the 21 CCC loans for the 2000 crop year through forfeiture. In order to make payments against the remaining loans, it had to sell some of its sugar at a price much lower than the loan amount due on the same sugar. This necessarily left the company with insufficient funds to clear all of its CCC loans. There appears to be some dispute between the parties as to whether four or five loans remain outstanding, but it is undisputed that after satisfaction of the Government's claims, no sugar or proceeds remain to apply toward the Growers' claims.

IV. Procedural History

After PNSC defaulted on its payments, the Growers attempted to foreclose on their processor liens in state court. The Government intervened and removed the case to Federal court. The Growers sought a declaration that their processor liens were superior to the CCC liens or in the alternative, that the application of 7 U.S.C. §7284(d) was an unconstitutional taking.

The District Court for the Eastern District of Washington found that the CCC liens were indeed superior to Growers' state law liens, and granted the CCC's Motion for Summary Judgment. Bair v. Pacific Northwest Sugar Co., LLC, No. CS-01-0310-AAM (ED. Wash. Feb. 21, 2002) (unpublished). The Court of Appeals for the Ninth Circuit affirmed. *Bair v. Pacific Northwest Sugar Co. LLC*, 85 Fed.Appx. 555 (9th Cir. 2004) (not selected for publication in the Federal Reporter). Because the Growers' takings claim against the United States exceeds $10,000, the U.S. Court of Federal Claims has exclusive jurisdiction to render judgment. 28 U.S.C. §§ 1346, 1491.

On November 19, 2004, the Growers filed a complaint in this Court based on their takings theory of the case.

## Discussion

### I. Standard of Review

This case comes before the Court on cross motions for summary judgment. The standard for determination is well-known. Summary judgment is appropriate when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. Rules of the United States Court of Federal Claims ("RCFC") 56(c); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). In making this determination, the Court must resolve all reasonable inferences in favor of the non-moving party. *Champagne v. United States*, 35 Fed. Cl. 198, 206 (1996). When, as here,

there are cross motions for summary judgment, the Court must evaluate each motion individually, making inferences against the moving party with respect to each motion. *DeMarini Sports, Inc. v. Worth, Inc.*, 239 F.3d 1314, 1322 (Fed. Cir. 2001). The existence of any factual dispute is not sufficient for a party to survive summary judgment – the dispute of fact must be material to the legal issue. *Liberty Lobby*, 477 U.S. at 247-48.

There are very few factual disputes in this case. None are material to the legal question of whether 7 U.S.C. § 7284(d) operates to effect a taking of the lien interests that the Growers could acquire in the beet crop.

II. Jurisdiction

Jurisdiction in this case is not disputed. However, the parties may not confer jurisdiction by agreement. The Court must satisfy itself. The Tucker Act confers jurisdiction upon the United States Court of Federal Claims over certain suits for money against the United States founded upon the Constitution or other laws and waives sovereign immunity. 28 U.S.C. §1491. The substantive right to money from the United States must be found outside the Tucker Act. *See e.g., United States v. Mitchell*, 463 U.S. 206, 216-217 (1983). Constitutional jurisdiction must be based on a money-mandating constitutional provision. Id. The takings clause of the Fifth Amendment is such a provision. *See e.g. United States v. Causby* 328 U.S. 256, 267 (1946) ("If there is a taking, the claim is 'founded upon the Constitution' and within the

jurisdiction of the Court of Claims to hear and determine.")

III. The Alleged Taking

In order to succeed in a takings claim, the Growers must first establish that they have a property interest protected by the Fifth Amendment. *Members of Peanut Quota Holders Assoc., Inc. v. United States*, 421 F.3d 1323, 1329 (Fed. Cir. 2005). There is general acceptance of the view that liens are property for purposes of the Fifth Amendment.

Liens can be created by common law, statute or equity. 1 Law of Debtors and Creditors § 9:2. Using the familiar 'bundle of sticks' metaphor for property interests, the sticks that make up a statutory lien are such things as the class of creditors who may assert it, the class of debtors against whom it may be applied, the type of property that may be attached, the procedures for perfecting the lien, and most important for our purposes, the priority of the lien as against competing security interests. Id. at §§ 9:7-12. The sticks that make up the processor liens at issue here are defined in Wash. Rev. Code § 60.13.020 et seq. The Government's position is that the Growers' lien interests are further defined by the terms of the federal sugar loan program statute, particularly the CCC super-priority provision, 7 U.S.C. § 7284(d). The parties have offered up two widely different theories of the effect of Federal law on the Growers' property interests. We start with a discussion of the Growers' position.

A. Growers' "Destruction of Value" Theory

The Growers advance the proposition that government action that destroys the value of a lien or renders it unenforceable constitutes a Fifth Amendment taking. Plaintiffs' Memorandum 9; Plaintiffs' Reply and Response 20. The Growers' argument, in its simplest terms, is as follows: Under the Washington statute, the Growers' processor liens attached as of the date of delivery of the beets, before PNSC applied for or received the CCC loans. The Growers are now unable to collect anything on the liens because the later in time super-priority CCC liens have exhausted the assets of PNSC. Therefore, a taking of their property interest in the liens must have occurred in the interim.

The Growers cite in support *Armstrong v. United States*, 364 U.S. 40 (1960), *Shelden v. United States*, 7 F.3d 1022 (Fed. Cir. 1993), *In re Metmor*, 819 F.2d 446 (4th Cir. 1987) and *Murray v. United States*, 817 F.2d 1580 (Fed. Cir. 1987). Each of these cases involves a security interest attaching to property owned by private parties that later became the property of the government. In each case, the holders of the security interest prevailed in the vindication of their property interest. However, we find the cases inapposite to the Growers' claim.

In Armstrong, pursuant to contract, the government took title to several boats being constructed for the Navy when the prime contractor defaulted. Plaintiff subcontractors had state-law

materialmen's liens on the boats. When the government took title, the liens were rendered useless because the doctrine of sovereign immunity barred their enforcement. The Supreme Court held that the destruction of the liens constituted a Fifth Amendment taking.

In *Shelden*, the innocent third-party plaintiffs had a mortgage interest in property seized by the government under RICO forfeiture provisions (18 U.S.C. §§ 1961 et seq.). The court held that title to the property was effectively transferred to the United States by the Order of Forfeiture. As in *Armstrong*, the doctrine of sovereign immunity made the otherwise valid mortgage lien legally unenforceable. The Federal Circuit concluded that a taking had occurred.

In *Metmor*, the government seized property under the Comprehensive Drug Abuse Prevention and Control Act (21 U.S.C. § 881) subject to a mortgage lien held by the innocent third-party plaintiff, but refused to make interest payments due under the mortgage. The court found that *Metmor's* rights in the property encompassed the right to interest payments. The statute prevented government seizure of any property rights held by innocent owners. Although cited by the Plaintiffs for the court's positive treatment of Armstrong, strictly speaking, *Metmor* does not involve a taking. It is well-established that a government appropriation of property must be authorized by law in order to be subject to analysis as a taking. *See e.g. Short v. United States*, 50 F.3d 994, 1000 (Fed. Cir. 1995). The court in *Metmor* found that

the government's action was contrary to law, not an otherwise lawful taking requiring compensation.

*Murray* also involved government activity contrary to law. It concerns a refusal by the IRS to allow mortgage holders to redeem foreclosed property, contrary to 26 U.S.C. § 6337(b)(1) (1987). The court cited the takings analysis of Armstrong and held that the Murrays had established a cause of action. The merits of the plaintiffs' takings claim were never addressed because on remand, the underlying mortgage interest was held invalid. *Murray v. United States*, 15 Cl. Ct. 17 (1988), aff'd, 864 F.2d 148 (Fed. Cir. 1988).

In summary, each of the cases cited by the Growers is distinguishable. The taking in *Armstrong* was occasioned by operation of a government contract to which the lienholders were not parties, rather than a statute, making it of questionable value as precedent for our purposes. By contrast, *Shelden* does involve a statute (the RICO forfeiture provisions, 18 U.S.C. §§ 1961 et seq.). In both cases, however, the doctrine of sovereign immunity created an absolute barrier to the enforcement of liens against property titled to the government. The liens were rendered legally unenforceable, thus destroying them utterly. *Metmor* and *Murray* are similar to *Shelden* and *Armstrong* in this respect – the government action amounted to completely ignoring the legal existence of the security interests, not changing their value. In contrast, the processor liens here are still legally recognized, although their value may be

impaired by the absence of sufficient assets to satisfy prior claims.

In addition to the absence of legal support for their position, the Growers' theories confront practical problems. The exact nature and timing of the government action that constitutes a taking was never clarified in the Growers' briefs or in oral argument before this Court. We think the Growers' difficulty in pinpointing the taking is due to the fact that their losses are actually the result of financial and market circumstances, not government action. It is true that the Growers can expect to recover nothing from their 2000 processor liens. However, unlike the cases cited by the Growers, the government action here does not create an absolute legal barrier to enforcement of their claims. In *Armstrong*, the dollar value of the uncompleted boats made no difference; there was no way for the materialmen to enforce their claims because of sovereign immunity. Similarly, in Shelden, the "critical fact" was that "the Sheldens could not enforce the mortgage against the United States." 7 F.3d at 1028. The value of the mortgaged property had nothing to do with enforceability.

The Growers' theory, in contrast, makes the existence or non-existence of a taking dependent on management practices or market conditions, rather than on the nature of the challenged government activity. If PNSC had had enough storage capacity to permit it to forfeit on all of the 2000 sugar loans, or if the market price of sugar had been high enough, the CCC security interests could have been satisfied. Sugar and proceeds might have remained

to satisfy the Growers' claims. A lien is not a guarantee of payment – even in the absence of the super-priority statute, each grower's lien would still be inferior to tax and labor liens under the terms of the Washington statute, and also to the liens of growers who delivered beats earlier in the season.

B. The Government's "Pre-Existing Limitation" Theory

The Government contends, and we agree, that 7 U.S.C. § 7284(d), giving CCC security interests priority over other liens, modified the statutory definition of the processor lien. When the Growers' liens attached, they were already subject to the possibility that the CCC would acquire a higher priority interest. The Federal statute created a pre-existing limitation on the property rights that the Growers could acquire under state law. The Growers still have what they always had – valid liens on the sugar attaching on the date of delivery, but liens that are secondary to superior CCC security interests that might thereafter attach. Since the Growers' liens were always subject to the limitations of § 7284(d), that law's application does not constitute a taking.

In support of its pre-existing limitation argument, the Government analogizes § 7284(d) to the lien avoidance provision of the Bankruptcy Code, 11 U.S.C. § 522(f). The provision allows debtors to avoid the operation of liens attached to certain types of exempt property such as household goods, implements of the debtor's trade, or medically prescribed health aids. Creditors with

non purchase-money, non-possessory security interests attaching to the covered categories cannot enforce them against debtors who file for bankruptcy. Like processor liens affected by the CCC super-priority provision, the security interests affected by § 522(f) attach before the action of the debtor brings the statute into play by filing for bankruptcy.

The Supreme Court confirmed the constitutionality of § 522, at least implicitly, in *United States v. Security Industrial Bank*, 459 U.S. 70, 75 (1982). The case involved a challenge to the retroactive application of the lien avoidance provisions to security interests created before the passage of the statute. The court read the statute to apply only prospectively in order to avoid a violation of the Fifth Amendment. Implicit in the court's reading is an acknowledgment of the constitutionality of prospective application and of the "pre-existing limitation" theory.

The case *In re Leicht*, 222 B.R. 670 (B.A.P. 1st Cir. 1998) provides the clearest formulation of the pre-existing limitation argument. The Government did not cite this case in its original brief, although the Government relies extensively on other cases approving § 522, including *In re Thompson*, 867 F.2d 416 (7th Cir. 1989) and *In re Weinstein*, 164 F.3d 677 (1st Cir. 1999). Although it recognized that liens are property interests protected by the Fifth Amendment, the court in *Leicht* found that no taking had occurred. A lien "is no more than what the law defined it to be at the time it arose. And here is the Achilles heal of

[creditor's] takings challenge. The lien was born subject to the Leicht's right to avoid it pursuant to § 522(f)(1)." 222 B.R. at 683. The lien avoidance provision operated as a pre-existing limitation on property rights.

The Growers challenge the applicability of the § 522 cases to the current dispute, arguing that bankruptcy is a special context because of the specific grant of power to establish "uniform Laws on the Subject of Bankruptcies." U.S. Const. art. I, § 8, cl. 4. We find this argument unconvincing and flatly contradicted by the case law. *See e.g. Security Industrial Bank*, 459 U.S. at 75 ("The bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation."); see also *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935) ("The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment.")

There is a very clear distinction between the § 522 cases and the Growers' lien destruction cases. The lien avoidance provisions of the Bankruptcy Code are designed to alter property interests, making them similar to the lien priority provision at issue in this case.

The Growers contend that the holdings in *Armstrong*, *Shelden* and *Metmor* contradict the Government's pre-existing limitation theory because the courts found that takings had occurred even though the forfeiture statutes at issue (or the doctrine of sovereign immunity in *Armstrong*)

predated the creation of the disputed liens. This argument fails because the statutes at issue in the Growers' cases were not directed at property interests. The forfeiture provisions of RICO and the Comprehensive Drug Abuse Prevention and Control Act are intended to seize property that has been 'tainted' by criminal activity. Nothing in either statute purports to alter the property interests of innocent third parties. Similarly, the doctrine of sovereign immunity is a general legal principle not specifically directed at property interests. The impact on property rights in those cases was incidental to Congress' real aim. In contrast, § 7284(d) directly addresses lien priority, altering the Growers' liens from the outset.

At the request of the Court, the Parties provided supplemental' briefing on whether the priority of Federal tax liens possibly provided a useful analogy for deciding this case. However, Federal tax lien cases are not specifically helpful in addressing the Fifth Amendment takings claim at issue here.

Neither the parties nor the Court has found any cases involving the taking clause and its possible application to federal tax lien priority. However, the cases do underline the conditional nature of the Growers' lien interests. Prior to Congressional action protecting certain classes of non-federal liens (passage of the Federal Tax Lien Act of 1966, Pub. L. No. 89-719, 80 Stat. 1125), the courts protected the priority of Federal tax liens with an extremely strict "choate lien" test that modified the normal "first in time is first in right"

principle. *See In re Estate of Romani*, 688 A. 2d 703, 706 (Pa. 1997) (discussing *United States v. Kimball Foods, Inc.*, 440 U.S. 715 (1979)). It is well-established that although the existence of an attachable property interest is a matter of state law, the priority of Federal liens that may attach to it is a Federal question. *See United States v. Craft*, 535 U.S. 274, 278 (2002) (citing *United States v. Bess*, 357 U.S. 51, 56-57 (1958)). The essential point of this brief foray into Federal tax lien jurisprudence is that state created property rights are circumscribed or modified by federal law in a number of contexts, without amounting to a taking under the Fifth Amendment.

**Conclusion**

For these reasons, we find that 7 U.S.C. § 7284(d) operated to alter the nature of the Growers' processor liens from their inception. Therefore, the Growers have not suffered a taking. **The Plaintiffs' Motion for Summary Judgment is DENIED, and the Defendant's Cross Motion is GRANTED. Clerk of the Court is directed to enter judgment in favor of the Defendant.** Parties are to bear their own costs.

IT IS SO ORDERED.

/s/
LAWRENCE M. BASKIR
Judge

**APPENDIX C**

**In the United States Court of Federal Claims**

No. 04-1689 C (consolidated)

**ROSS L. BAIR, et al.**

**JUDGMENT**

v.

**FILED JAN 11 2007**

**THE UNITED STATES**

Pursuant to the court's opinion, filed January 11, 2007,

IT IS ORDERED AND ADJUDGED this date, pursuant to Rule 58, that judgment is entered in favor of defendant, and the complaint is dismissed. The parties are to bear their own costs.

Brian Bishop
Clerk of Court

By: /s/
Deputy Clerk

January 11, 2007

NOTE: As to appeal, 60 days from this date, see RCFC 58.1, re number of copies and listing of all plaintiffs. Filing fee is $455.00.

## APPENDIX D

**United States Court of Appeals for the Federal Circuit**

2007-5049

ROSS L. BAIR, LYLE K. BAIR, BAIR BROTHERS, BAIR FARMS, INC., BERGESON FARMS, INC., CEEKAYDEE FARMS GENERAL PARTNERSHIP, KEITH B. CHILD, CORBETT DRAW FARMS GENERAL PARTNERSHIP, D & D GILBERT FARMS, INC., TOM DOWNS, J. LAMAR GILBERT, DAVID HAMMOND, JERRY HODGES, CHRIS HYER, JOHN HYER, MARK IVERSON, L. SHEFFELS & SONS, INC., LEON R. BAKER FARMS, LLC, JERRY C. MILBRANDT, R & J FAMILY FARMS, INC., ALLAN ROBEL, RONALD ROYLANCE FARMS, INC., ROYLANCE COULEE PARTNERSHIP, RANDY ROYLANCE, SBS FARMS, LLC, TRAVIS STEFFLER, PAUL STOKER, STOKROSE FARM AND FEEDLOT, TIM TAYLOR, TRACY LYBBERT FARMS, INC., DUANE MARCUSEN, LUIS A. MARTINEZ, FRANK MARTINEZ, LEGACY FARMS, INC., SHANE CHRISTENSEN, J. LYN WOOD, PIERCY FARMS, INC., AG CAPITAL COMPANY, KEVIN JENKS, ROGER ROYLANCE FARMS, INC., LARRY SCHAAPMAN, DAVID EDLER, CIRCLE D, INC., DIAMOND M, INC., D. GLEN BAIR, and WASHINGTON STATE DEPARTMENT OF NATURAL RESOURCES,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in consolidated case 04-CV-1689, with 04-CV-1846, 04-CV-1847, 04-CV-1848, 04-CV-1849, 04-CV-1850, 04-CV-1851, 04-CV-1852, 04-CV-1853, 04-CV-1854, 04-CV-1855, 04-CV-1856, 04-CV-1857, 04-CV-1858, 04-CV-1859, 04-CV-1860, 04-CV-1861, 04-CV-1862, 04-CV-1863, 04-CV-1864, 04-CV-1865, 04-CV-1866, 04-CV-1867, 04-CV-1868, 04-CV-1869, 04-CV-1870, 04-CV-1871, 04-CV-1872, 04-CV-1873, 04-CV-1874, 04-CV-1875, 04-CV-1876, 04-CV-1877, 04-CV-1878, 04-CV-1879, 04-CV-1880, 04-CV-1881, 04-CV-1882, 04-CV-1883, 04-CV-1884, 04-CV-1885, 04-CV-1886, 04-CV-1887, 04-CV-1888, 04-CV-1889, and 04-CV-1891, Judge Lawrence M. Baskir.

ORDER

NOTE: This order is nonprecedential.

**UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT**

**ORDER**

A combined petition for panel rehearing and for rehearing en banc having been filed by the Appellants, and a response thereto having been invited by the court and filed by the Appellee, and the petition for rehearing and response, having been referred to the panel that heard the appeal, and thereafter the petition for rehearing en banc and response having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for panel rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en bane be, and the same hereby is, DENIED.

The mandate of the court will issue on April 7, 2008.

FOR THE COURT,

/s/
Jan Horbaly
Clerk

Dated: 03/31/2008

cc: Bryce J. Wilcox
Steven M. Mager

**FILED**
U.S. COURT OF
APPEALS FOR THE
FEDERAL CIRCUIT

MAR 31 2008

JAN HORBALY
CLERK

BAIR V US, 2007-5049
(CFC – 04-CV-1689)